1. The Working Party on Italian Measures, established by the Council of Representatives at their meeting of 17 September 1976 (C/M/116) was asked:

"To examine, in the light of the relevant provisions of the General Agreement and of the statements made in the Council on this subject, the monetary measures introduced by Italy in May 1976 (L/4353), in particular the deposit requirement for payments abroad, and their implications; to report to the Council and to continue to be available as necessary."

2. The Working Party noted that Deposit Requirements for Payments Abroad had been introduced, among other monetary measures, in Italy with effect from 6 May 1976; it subjected payments abroad (and imports inter alia) to a non-interest bearing deposit requirement of 50 per cent. This measure was later extended and modified (see L/4353 and Adds. 1, 2 and 3, and L/4354 and Adds. 1, 2 and 3). The deposit requirement is scheduled to be reduced and phased out by 15 April 1977. The Working Party also noted that on 23 October 1976 Italy had introduced a 7 per cent special tax on the purchase of foreign exchange; that this measure had not been notified to the GATT, but that the legal texts were submitted to the Working Party (see Annex I).

3. The Working Party met on 8 November 1976 and in accordance with the provisions of Article XV of the General Agreement carried out a consultation with the International Monetary Fund, which supplied two background papers dated 22 September and 13 October 1976.

4. The Working Party heard a statement by the representative of the European Communities who stressed the monetary and exchange character of the Italian measures, which were applied, as a rule, to all purchases of foreign exchange, whether for imports, services or other purposes. He added that from the GATT point of view, these measures were dealt with by the provisions of Article XV and could not be compared to traditional restrictions such as import deposits or surcharges which affect imports only. He recalled that the deposit requirement on the purchase of foreign exchange had been examined in different fora, including in the IMF and that the Communities were prepared to discuss them in this Working Party according to the terms of reference. The Communities were also prepared to explain the 7 per cent special tax
on the purchase of foreign exchange recently introduced by Italy - and for this purpose the text of the decree was submitted for annexing to the report - although they could not say very much at this stage about its effects or prospects. The representative of Italy made a statement, the full text of which is reproduced in Annex II, in which he recalled the difficulties encountered by the Italian lira on exchange markets that had led his authorities to adopt a number of monetary measures, among which the deposit on the purchase of foreign exchange. He stressed the monetary and exchange character of the measure, described its positive effects on the exchange rate, and stated that it had no restrictive impact on the trend of imports which, on the contrary, had increased substantially since the introduction of the deposit. A further deterioration of the exchange rate had led to the introduction on 1 October 1976 of a special temporary tax of 10 per cent on the purchase of foreign exchange; this had been in force for two weeks and due to the renewed deterioration of the lira was replaced on 23 October 1976 by a 7 per cent special tax on the purchase of foreign exchange, due to expire in four months. He explained further that these measures had been taken in conjunction with a number of fiscal and monetary measures. He also described the balance-of-payments situation and the reasons for the severe deficit on current account, as well as the high rate of inflation, budgetary and public institutions indebtedness and the measures taken or envisaged to correct the accumulation of these problems. With regard to the recently introduced 7 per cent special tax on the purchase of foreign exchange he explained that his authorities were examining the possible effects of this measure and would endeavour to terminate it before the date of expiry established. He added that an even more rapid depreciation would have had, in the short run, certain advantages for Italian exporters, but these would have been considered intolerable by other trade partners. He concluded by saying that the measures introduced on 6 May 1976 as well as the special tax of 7 per cent were measures whose objectives were in conformity with the General Agreement as their aim was to facilitate a regular and harmonious development of Italy's trade with all other countries.

5. The Working Party heard a statement by the representative of the International Monetary Fund, the full text of which is reproduced in Annex III, which concluded as follows:

"In the light of the critical balance of payments situation of Italy the imposition of the deposit requirement on purchases of foreign exchange was warranted on a temporary basis, and its later extensions have been necessitated by the delay in introducing comprehensive alternative measures that would help restore equilibrium in the balance of payments on a sound and lasting basis."

With regard to the 7 per cent tax on the purchase of foreign exchange introduced on 23 October 1976 for a period of four months he added that the Fund had been informed and had had discussions on this matter, although no formal action had
taken place. The tax should be considered as an emergency measure rather than a solution and it was too early to project the possible effects it could have. It would, of course, have some restrictive effect on trade. He concurred with the statement by the representative of Italy that efforts should be made to eliminate the measure as soon as possible and recalled the Fund's view that there was urgent need for progress on a comprehensive programme to cope with the problems of the Italian economy.

6. Members of the Working Party thanked the representative of Italy and of the International Monetary Fund for their comprehensive and detailed statements on Italy's balance-of-payments situation and restrictive measures. They noted that Italy was not invoking Article XII. They stressed the importance attached to the careful examination in the appropriate GATT body, of all restrictive measures having a direct or indirect effect on trade, be these measures monetary in form or not. There was some divergence of views as to what constituted an appropriate GATT body, the Balance-of-Payments Committee or an ad hoc Working Party. Some members stressed the need for uniformity in the examination of balance-of-payments measures in the GATT and regretted the fact that a number of different procedures and practices had been followed in this respect. The representative of the European Communities recalled that the terms of reference of the Balance-of-Payments Committee provided for the examination of measures adopted under the provisions of Articles XII and XVIII:B. The GATT was characterized by its pragmatism and the flexibility of its examination procedures, which allowed for the diversity of situations which could arise. Another member said that his authorities had carefully traced the genealogy of the Balance-of-Payments Committee's terms of reference and stated that the Council could refer all measures affecting balance of payments to that Committee.

7. Members of the Working Party expressed full understanding for the seriousness of the balance-of-payments and economic situation prevailing in Italy. It was also appreciated that corrective measures were called for but it was regretted that the Italian authorities had had to resort to the imposition of a deposit on the purchase of foreign exchange which could not fail to have an impact on trade. With regard to the recently introduced 7 per cent on the purchase of foreign exchange some members of the Working Party asked that this measure be notified to the contracting parties. They felt that it was not an appropriate measure, in terms of its effects on trade, to solve the fundamental problems of disequilibrium. It was further regretted that the deposit requirement due to expire on 6 November 1976 had been prolonged. The Working Party welcomed the fact that the measures were non-discriminatory in their application. However, members of the Working Party underlined the temporary and emergency nature of the measures and felt that they should be replaced as soon as possible by comprehensive alternative measures that would help restore equilibrium on a more lasting basis. One member of the Working Party, while regretting the balance-of-payments need to impose a prior deposit, and feeling that the special tax was inappropriate in this case, welcomed the fact that Italy had chosen broad, non-discriminatory measures such as a prior deposit instead of more restrictive measures such as quantitative restrictions.
8. Several members of the Working Party asked what the prospects were for developments in the balance-of-payments situation for the end of 1976 and for 1977. The representative of Italy remarked that although official forecasts existed they should always be allowed a margin for error. At present official forecasts pointed to a surplus in 1977 of some Lit 100 to 200 billion on current account. The situation for the capital account would be quite different as in 1977 there was a large part of foreign loans to be repaid. Details were asked on the more comprehensive measures which had been adopted or which were in preparation to restore equilibrium. The representative of Italy explained that a number of emergency measures had been adopted by the Government and had to be enacted by Parliament to remain in force to correct the situation; there were measures to encourage the return of private expatriated capital, which had had no notable effects so far. He added that both the Italian Government authorities and legislative powers were fully aware of the gravity of the economic situation and of the need to adopt austerity measures to redress it. Other measures taken included increases in the Bank of Italy discount rate, increases in administered prices, in the withholding tax on distributed company profits and the compulsory investment in government bonds of inflation-linked wage increases above a specified level.

9. Members of the Working Party noted that the current rate of inflation in Italy was running at some 20 per cent per annum and asked questions on contributing factors such as budget deficits and wage policy. It was noted that real wages had increased by more than 10 per cent, and had not been matched by a corresponding increase in productivity. It was also asked how the budget deficit would be financed in 1977. Also in this context, it was asked whether the Italian authorities expected the 7 per cent tax on exchange as well as the refunding of the deposits on exchange, to have an inflationary impact by making imports more costly. The representative of Italy recalled that a number of measures had been adopted to mop up excess liquidity in the market such as the increase in the bank rate. Increases of real wages had presented a more difficult problem. He explained that Italy had a system of "scala mobile" (moving-scale) payments which, for social reasons, linked wages automatically with cost-of-living increases. Thus even an attempt to reduce liquidity by increases in taxes and in prices of administered goods had been frustrated to some extent as these were items that were included in the price index to which wages were pegged. Action was being considered by the Government to reduce the rate of wage increases and to bring them under better control. With regard to the budget deficit the representative of Italy, recognized the need to reduce the deficit but said that public expenditure was notably rigid and that there was little margin to significantly reduce expenditure. Nevertheless, estimates for 1977 had foreseen a reduction of Lit 1,000 billion in the deficit i.e. from Lit 14,000 billion in 1976 to Lit 13,000 billion in 1977. With regard to the effect of the 7 per cent special tax the representative of Italy confirmed that it would make imports more costly and that his authorities shared the concerns of the members of the Working Party in the possible inflationary impact of this measure. They hoped to abolish the measure before the date of expiry. For the present, his authorities had had no choice but to impose it in order to contain the level of speculative imports and the corresponding decline of reserves.
10. Several questions were asked with regard to the deposit requirement for foreign exchange: whether the effects of the deposit on trade could be quantified and whether the Italian authorities were satisfied with the effectiveness of the measure in reducing liquidity. It was noted that the measure was applied on a non-discriminatory basis and that it would be phased out gradually by 15 April 1977. Members of the Working Party expressed concern that as the measure would be phased out and refunds effected the result would be to increase the level of liquidity. The representative of Italy replied that the deposit had been an effective measure to mop up excess liquidity; to date it was estimated that some Lit 4,000 billion had been withdrawn from circulation through the deposit requirement. As such the measure was effective to reduce the level of liquidity. The Italian authorities had not felt up to now the effects of the refunds; however it was obvious that as the phasing out of the measure continued and refunds increased, liquidity would also increase. On the other hand other measures would help reduce the level of liquidity such as the 7 per cent special tax and the new ceilings on bank credits. The representative of the European Communities added that the effect on trade of the deposit requirements were not quantifiable, although it was clear that a 50 per cent deposit for ninety days would have some effect. He stressed that the measure was not only applicable to trade but also to services and payments and was essentially a monetary measure applied in the field of foreign exchange regulations. Some members of the Working Party felt the measure had a direct impact on trade. The representative of the European Communities added that statistics up to the month of July 1976 showed that there had been no reduction in volume or value of imports. The measure had therefore been essentially successful as a tool to mop up excess liquidity. In reply to a question on the possible effects of the reduction and phasing out of the deposits on the State budget the representative of Italy stated that there would be no effect on the budget as the money collected was not and could not be entered as State revenue. On the other hand the 7 per cent special tax did constitute State revenue and therefore would have some effect in reducing the budgetary deficit.

Conclusions

11. The Working Party examined the monetary measures introduced by Italy in particular the deposit requirement for purchase of foreign currency, of 6 May 1976, and a special tax of 7 per cent on the purchase of foreign currency, of 23 October 1976. The Working Party expressed understanding for the very serious economic and balance-of-payments problems of Italy and for the difficulties of recovery.

12. The Working Party regretted that emergency measures had had to be taken. It was of the view that these measures, although monetary in form, affected all external transactions, _inter alia_ trade, but were not more restrictive than an application of measures to safeguard the balance of payments expressly provided for in the General Agreement.
13. The Working Party welcomed the statement by the Italian representative that his authorities would study the effects of the 7 per cent special tax and consider its removal before its present date of expiry. It also invited the Italian authorities to consider an early removal of the deposit requirements on foreign exchange, and to replace these temporary measures by comprehensive alternative measures to help restore equilibrium as indicated in the finding of the International Monetary Fund.

14. The Working Party agreed that this conclusion was without prejudice to the rights of contracting parties under the General Agreement. The Working Party will keep the matter under review.
ANNEX I

Italy - Decree Establishing a Special Tax on Payments Abroad

Article 1

Until the date to be fixed by decree of the Minister for the Treasury, in agreement with the Minister for Finance and the Minister for Foreign Trade, and in any case until 18 February 1977 at the latest, purchases of foreign currency against Italian lire, whether cash or forward, in favour of Italian residents for the settlement of transactions authorized in a general or a particular way shall be subject to a special tax equivalent to 7 per cent of the amount of Italian lire paid for the foreign currency purchased.

The special tax shall likewise be payable on payments made abroad by approved banks for the account of Italian residents through the debit of a foreign exchange account, and on payments made by crediting Italian lire to accounts held by foreigners.

Article 2

The tax mentioned in the preceding article shall be payable by the approved banks which shall pass it on to the purchaser of the foreign currency at the time when the transaction is effected, or by the resident for whose account the payment is made abroad.

The special tax shall be paid to the Provincial Section of the State Treasury in the constituency where the headquarters or branch of the approved bank that executes the transaction is situated; this payment shall be made on the day following completion of the transaction.

The modalities for payment to the State Treasury shall be established by the Minister for the Treasury.

The proceeds of the special tax shall be entered under an ad hoc heading of the State revenue estimates.

Article 3

Payments in respect of the following transactions shall be exempt from the special tax:

- imports of wheat (tariff heading No. 10.01);
- imports of foreign newspapers and periodicals;
- payment to non-residents of pensions and savings, other social insurance allowances, subsistence allowances required by law;

- transfers of salary to Italian agents abroad;

- allowances to persons emigrating, subject to the established maximum of 5 million lire per person, in addition to the tourist allowance;

- payments, through the credit of foreign accounts, in connexion with credits granted under Law No. 131 of 28 February 1967;

- transfers of savings deriving from employment earnings (remittances by immigrants, including remittances of savings by non-resident workers temporarily in Italy);

- credit, on foreign accounts of shipping and air transport companies, of earnings deriving from the transport of passengers and goods;

- compensation payments to non-residents by insurance companies, in pursuance of the third-party responsibility of residents; transfers abroad in pursuance of judicial orders;

- imports of artificial kidneys and parts therefor and likewise of products derived from blood;

- foreign investments; income from foreign investments in Italy; transactions resulting from recognition of ownership by foreigners of goods and assets in Italy;

- contributions to international bodies of which Italy is a member;

- foreign payments made by ITALCABLE, TELESPAZIO and TELEMAR, in connexion with their activities;

- transfers of consular fees;

- reimbursement of financing in foreign exchange on the agreed due date, if optional, or when the event envisaged occurs, if compulsory;

- transfers through the intermediary of the Italian Exchange Office;

- payments made by order of the Special Commissioner for the earthquake-stricken areas of Friuli-Venezia Giulia;

- payments made by drawing on availabilities existing in foreign exchange accounts as at 22 October 1976;

- payments made by drawing on foreign exchange availabilities resulting from forward purchases prior to 22 October 1976;

- credit in Italian lire of accounts belonging to foreigners, in connexion with the transfer, for the benefit of residents, of ownership of goods and activities in Italy, in pursuance of Law No. 689 of 8 October 1976.
- transfers for foreign investments of Italian undertakings;
- transfers in foreign exchange, or in Italian lire on accounts belonging to foreigners, for medical care, studies, business, subsistence, on the basis of ad hoc authorizations;
- utilization of availabilities in "authorized", "special" and "suspense and other" accounts;
- credit in Italian lire or in foreign exchange payable abroad, to be used by the foreign party for payment of goods and services exported by Italian undertakings;
- payments in connexion with the purchase of securities to be issued by EIB and ECSC and permitted to be placed in Italy;
- purchases of foreign exchange for travel abroad, subject to a maximum amount of Lit 100,000;
- payments resulting from purchases abroad of provisions and supplies for Italian vessels and aircraft.

**Article 4**

During the twenty working days (i.e. excluding Saturdays and Sundays) preceding the expiry date mentioned in Article 1 of this Decree, percentage reductions of the special tax mentioned in Article 1 shall be determined by Decree of the Minister for the Treasury in agreement with the Minister for Finance and the Minister for Foreign Trade, having regard to the balance-of-payments situation and to exchange rates of Italian currency in foreign markets.

**Article 5**

The present Decree shall enter into force on the day of its publication in the Official Gazette of the Italian Republic and shall be submitted to the Chambers with a view to being made Law.

The present Decree, bearing the State seal, shall be included in the legislative series of the Italian Republic. All persons concerned shall be required to observe and ensure observance for it.

Rome, 23 October 1976
ANNEX II

Opening Statement by the Representative of Italy

Certain indications have already been given by the delegation of Italy at the meetings of the Council of Representatives on 14 June, 15 July and 17 September 1976. I consider it useful, however, that thorough examination of Italy's monetary measures should be based - in particular - on a detailed analysis of developments on Italy's exchange market.

At the beginning of 1976, the United States dollar was quoted at approximately Lit 680-682. A few days later, following strong pressure on the exchange market, the Italian authorities suspended official interventions - from 21 January till the end of February 1976. On 1 March, when the official market reopened, a United States dollar was worth Lit 771. The level of Lit 800 per dollar was passed a few days later (11 March 1976) and, despite certain interventions by the Bank of Italy, by the end of March the United States dollar was being quoted at approximately Lit 850. In April, the decline in the value of the lira vis-à-vis the dollar and other convertible currencies steadily continued.

By the end of April, the dollar was worth almost Lit 900 and on 5 May, Lit 916.

That was why the Italian authorities were compelled, on 6 May 1976, to adopt a series of measures to facilitate a return to a normal situation and halt speculation in the lira. Those measures were communicated to the GATT secretariat and were circulated in document L/4353. They are in the form of three Ministerial Decrees concerning:

- The frozen deposit requirement for payments abroad;
- the offer to supply foreign exchange to the "Ufficio Italiano dei Cambi" within a time-limit of seven days;
- the requirement of partial financing in foreign exchange in respect of short-term export credits.

As indicated in the above-mentioned communication, the measures adopted are of a temporary and purely monetary nature.

In particular, with reference to the requirement of lodging a non-interest bearing deposit of a sum equal to 50 per cent of the Italian lire used for the purchase of foreign currency for payments abroad, some details were already given at the 14 June meeting of the GATT Council by the representative of Italy, namely:

- The duration of the deposit was limited to ninety days;
- the deposit requirement would be temporary;
- the requirement applied to all purchases of foreign currency against lire, either cash or forward, for settling foreign transactions of any kind, whether in the commercial, financial or services sectors;
- the Decree provided for some exceptions, mainly in respect of certain payments relating to financial obligations contracted in the past in the course of normal banking activities or certain special activities, etc.;
- as regards purchases of foreign currency for the payment of imports, only one significant exception was made and that related to wheat.

The representative of Italy also emphasized that the measures were strictly monetary and not trade measures. The deposit requirement did not entail any new restrictions or hindrance to the passage of goods across the country's borders. The requirement was effective only at the level of payments, which meant that the import procedures remained the same as before 6 May.

It must therefore be stressed that the measures were completely different from the prior import deposit which, for example, Italy had adopted in May 1974.

The constructive effects of the above measures on the Italian exchange market were immediately felt: the lira rapidly improved, with stabilization in the neighbourhood of Lit 840-850 to the dollar by the end of September 1976.

By document L/44353/Add.1, the contracting parties were informed of the decision of the Italian authorities to extend to 3 November 1976 the non-interest bearing frozen deposit requirement for payments abroad.

It was explained that the extension of the measure had been dictated by the need to allow sufficient time to complete a programme for a longer-term economic stabilization policy.

Lastly, as may be seen from the communication from the Italian Mission circulated in document L/44353/Add.2, the requirement of a deposit of 50 per cent for payments abroad is being progressively eliminated. The first reduction occurred on 15 October 1976 and the second will take place at the end of the current month. The percentage of the deposit will be further reduced on 15 January and 28 February 1977, and will be completely eliminated on 15 April 1977.

The fact that the measure is being eliminated gradually is due to the need to normalize the exchange market and avoid any undue disturbance of the position of the lira vis-à-vis other currencies.
However, all the measures thus far taken have not sufficed to stabilize the exchange market. On 1 October, as a result of strong speculative pressure, the dollar rose to Lit 873. The Italian authorities were obliged to introduce, for a period of two weeks, a special temporary tax of 10 per cent on purchases of foreign currency.

The new decision was adopted in conjunction with a number of other fiscal and monetary measures to check the fall of the Italian lira on the exchange market and to avoid a sudden, even more serious crisis.

The market stabilized at about Lit 840-844 to the dollar during the period the tax was imposed. When it expired, however, the depreciation of the lira on the exchange market continued (the dollar being quoted at about Lit 870). For that reason, the Italian authorities decided, on 23 October 1976, to reintroduce a special tax this time of 7 per cent, for almost all purchases of foreign currency. The measure was adopted in the form of an emergency decree which was submitted to Parliament for legislative enactment. The emergency decree provides that the special tax will remain in force until a date to be determined by a decree of the Minister for the Treasury, adopted in consultation with the Ministers for Finance and for Foreign Trade, but not later than 18 February 1977. It also provides that during the twenty working days prior to the expiry of the special tax, reductions will be made in the percentage, having regard to developments in the balance of payments and on the rate of the lira in foreign markets.

* * *

The continuing depreciation of the lira vis-à-vis the dollar and other convertible currencies is obviously a consequence of the deterioration in the country's balance of payments.

The representative of Italy informed the GATT Council, at its meeting of 17 September 1976, that from January to July 1976 the Italian balance-of-payments deficit had reached the very high level of Lit 1,463 billion ($1,800 million). While there was a surplus of Lit 255 billion for August, a traditionally favourable month, for September the Italian balance of payments again showed a deficit, which, according to preliminary data, amounted to Lit 530 billion. Thus, for the first nine months of the current year, the Italian balance of payments has shown a deficit of Lit 1,738 billion, equivalent at the present rate of exchange to approximately $2,100 million.

After allowing for the $1,200 million which the Bank of Italy "dumped" to maintain a certain stability on the foreign exchange market during the period January-September 1976, Italy's reserves now amount to $5,000 million, as follows:

- Gold and DTS $3,500 million (gold being valued at $42 per ounce);
- convertible currencies $1,500 million.
On the other hand, Italy's short, medium and long-term foreign indebtedness amounts to approximately $16,000 million.

The weighted depreciation of the lira, as calculated by the Bank of Italy in terms of February 1973 foreign exchange rates, is approximately 35 per cent vis-à-vis Western currencies.

As to the trade balance, we now have figures for the first nine months of 1976. In his statement to the GATT Council at its meeting of 17 September, the representative of Italy gave the figures for the period up to July 1976. In particular, he pointed out that while the average monthly value of imports had amounted to Lit 2,649 billion during the first four months of 1976, in the three following months, i.e. from May to July when the requirement of a 50 per cent deposit had been in force, that monthly average had increased to Lit 3,044 billion (approximately $3,620 million). August 1976 imports amounted to Lit 2,576 billion, but it must be borne in mind that during August there is usually a decrease in imports as compared with the months immediately preceding because of reduced output due to the summer holidays.

If, however, the imports of August 1976 are compared with those of the corresponding month of 1975, one notes a very substantial increase (58.3 per cent). Indeed, for September, there has been a new surge of imports, due to the resumption of production activity; in value terms, imports amounted to Lit 3,225 billion, i.e. a record. I should like to stress that point. The trade deficit for August 1976 was Lit 346 billion and for September, Lit 512 billion. For the period January-September 1976, that deficit totalled approximately Lit 3,800 billion as against a deficit of Lit 1,377 billion for the corresponding period of 1975.

It goes without saying that petroleum has a very great deal to do with this deficit. In the first eight months of the current year, Italy imported Lit 4,668 billion worth of petroleum, but there are other sectors which are having a very serious impact on the development of the situation. I am referring in particular to the agriculture-food sector, which had a deficit of Lit 2,100 billion.

I thus far have been dealing with the measures adopted by the Italian authorities with respect to the exchange market and foreign currencies, and with the economic situation and balance-of-payments position responsible for those measures.
I should like to add that those measures are of course no cure for the ailments which are afflicting the Italian economy, since they deal with the symptoms and not the causes of the ailments. They are thus emergency measures, selected from among those which, in principle, apply to all transactions. The object is to gain time until measures of another kind, working inside the system on the real flows and not on the monetary flows, can restore the situation. It is also obvious that if the lira had been abandoned to speculative and market forces, its subsequent depreciation would have not only done serious harm to economic and social stability in Italy but also constituted a factor of disturbance on international markets.

On the one hand, given the indexation of wages, any worsening of the exchange rate is quickly reflected in increased costs and prices, and consequently causes further inflation. This is demonstrated by the fact that the rate of inflation, which during the first quarter of 1975 had declined to less than 12 per cent on an annual basis, went up again to levels above 20 per cent after the depreciation of the first months of 1976.

On the other hand, a brutal devaluation of the lira would, in the short term, have given Italian exports certain advantages in other markets, which would have been regarded as intolerable by several local producers and by competing third countries. It must also be emphasized, on the basis of the figures I have quoted, that imports have not fallen as a result of the monetary measures in question.

* *

I now pass on to the programme which the Government, welcoming the well-founded suggestions and recommendations of the EEC Commission and the IMF, is engaged in to put the country's economic house in order.

The direct causes of the deficit in the balance of payments are the following:

(a) Increased prices for energy products;
(b) speculative movements of private capital;
(c) massive purchases of foreign products, in particular in the food sector.

Over and above all that, there is in any case excess liquidity and therefore excess demand by private persons, excessive indebtedness of the State and of public institutions (social insurance, local authorities, etc.), loss of competitiveness by industry owing to imbalances as between increases in costs and in productivity.

It is in those multiple directions that the Government proposes to act.
The additional information supplied by the IMF on 13 October has already made reference to the raising of the discount rate to the extraordinary level of 15 per cent, which means a prime rate of more than 20 per cent, and to the Government's measures of 8 October 1976. Those measures consisted of the adjustment of charges for certain public services (railway, postal, telegraph services) and of some controlled prices (fertilizer, petrol and other petroleum products).

It was also decided to increase the tax on dividends from 30 to 50 per cent and to freeze the indexation of upper-bracket salaries. Subsequently, telephone and electricity charges were increased, and provision was made for raising the cost of other products subject to price control (sugar, cement, pharmaceutical products, automobile insurance rates, methane-gas).

At the same time, in the monetary sphere, credit ceilings effective until March 1977 were introduced. The ceilings were calculated with a view to keeping the expansion of global financing within the limits strictly necessary to finance production activity and to prevent the formation of excess liquidity from being reflected in increased pressures on the exchange rate of the lira.

The total reduction in demand which should result from the various fiscal and quasi-fiscal charges in 1977 has been estimated at Lit 4,000 billion, i.e., 2.5 per cent of gross national product.

On the other hand, it is also planned to associate this deflationary action with industrial improvement action aimed at reducing costs and increasing productivity. The Government has already tabled a Bill for the conversion and restructuring of industry and is preparing another Bill which provides for partial assumption by the State of industry's social insurance charges.

It is hoped that these measures will suffice to start up a process of rehabilitation. As to the special tax of 7 per cent, I can say that the Italian authorities, too, are engaged in continuing efforts to evaluate more precisely the impact of this new type of measure, including its impact on the domestic market.

In any case, I can give a formal assurance that the authorities of my country will do everything possible to eliminate the special tax before the date set.

In conclusion, my delegation has no doubt concerning the monetary nature of the measures taken on 6 May last. The special tax of 7 per cent is also of a monetary character and is part of the efforts the Italian authorities are making to defend the lira on the exchange market.

The measures of 6 May 1976 and the introduction of the special tax on the purchase of foreign currency are consistent with the objectives of the General Agreement. They are contributing - and I wish to stress this important point - to orderly and harmonious development of Italy's trade with all countries.
Following the adoption of a series of deflationary monetary and fiscal measures beginning in the second quarter of 1974, the Italian balance of payments began to show signs of improvement in the second half of 1974, when there was a sharp turnaround in the capital account from a net outflow to a significant net inflow, and the volume of imports declined in relation to the first half of the year. The easing of the critical balance of payments situation permitted the authorities to abolish, in March 1975, the import deposit requirement that had been introduced some ten months earlier.

The improvement in Italy's balance of payments situation in 1975 was largely attributable to the depressed level of domestic demand in the first nine months of the year. Over 1975 as a whole, there was a large decline in the trade deficit, as import volumes declined by over 11 per cent and import values by 6 per cent, while exports increased by some 2 per cent in volume and 16 per cent in value. The trade deficit on an f.o.b. basis, which had reached an unprecedented SDR 7,076 million in 1974, declined to SDR 944 million in 1975. Most of this improvement took place in the first three quarters. Combined with a larger than expected surplus on services and transfers, primarily due to improved tourist revenues, the current account deficit was reduced from SDR 6,593 million in 1974 to SDR 455 million in 1975. On a quarterly basis, the current account swung from a deficit of SDR 372 million in the first quarter of 1975 to a surplus of SDR 114 million in the second quarter, and of SDR 720 million in the third quarter of 1975.

In August 1975, the authorities adopted a reflationary program which included: (1) new budgetary expenditures on projects in housing, public works, public transportation, and agriculture; (2) appropriations to revive economic activity in the south; (3) interest rate subsidies to small private businesses; and (4) an expansion of the funds available for export credit guarantees and for interest subsidies on export credits. Despite these measures, real GDP in 1975 is estimated to have declined by nearly 4 per cent, with gross fixed capital formation falling by 13 per cent and industrial production by 9.5 per cent.

These reflationary policies, superimposed on sharp wage increases granted earlier in the year, began to have an adverse impact on the balance of payments almost at once. Net autonomous capital inflows of SDR 355 million and SDR 70 million in the first and second quarters of 1975 reversed sharply beginning mid-1975, and outflows of SDR 460 million and SDR 446 million were recorded in the third and fourth quarters of 1975. Furthermore, the current account of the
balance of payments recorded a deficit of SDR 909 million in the last quarter of 1975, due largely to a rapid growth in imports. Thus, although the overall balance of payments improved from a deficit of SDR 6,396 million in 1974 to a deficit of SDR 922 million in 1975 as a whole, the fourth quarter of 1975 alone already registered an overall balance of payments deficit of over SDR 1,000 million.

The 1975 balance of payments deficit was financed largely by external borrowing by the monetary authorities, which was used also to retire compensatory loans falling due in the year. In 1975 Italy made a drawing of SDR 300 million under the IMF stand-by arrangement and a further drawing of SDR 780 million under the IMF oil facility. Gross official reserves fell by nearly SDR 1,600 million in 1975 to SDR 4,078 million at the end of 1975. The tradeweighted effective exchange rate of the lira (based on February 1973 parities) remained virtually unchanged during 1975, with the effective depreciation remaining around 20 per cent.

The balance of payments pressures that had begun to surface in the second half of 1975, and especially in November and December 1975, intensified in the first weeks of 1976. Gross official reserves excluding gold holdings fell to about SDR 500 million by January 20, 1976, when the Bank of Italy suspended official foreign exchange quotations. Official quotations were resumed on March 1, 1976. After staying roughly unchanged in 1975, the average effective exchange rate of the lira depreciated from 20.3 per cent at the end of 1975 (February 1973 = 100) to 25.6 per cent in the period immediately following the suspension of official exchange quotations, and further to 37.3 per cent in April 1976.

To counteract the speculative pressure on the lira the authorities on May 6, 1976, introduced a 50 per cent deposit requirement on virtually all purchases of foreign exchange. On May 17, 1976, the Executive Directors approved until August 5, 1976 the exchange restriction and the multiple currency practice involved in this deposit requirement. The Fund was later notified that the deposit requirement was being extended for a further three months primarily because it had not yet been possible to implement alternative measures to safeguard the foreign exchange position. On July 21, 1976, the Fund extended its approval of the measure until November 5, 1976.

On October 1, the Fund was informed that the termination of the deposit requirement was being further delayed and that it would now be phased out over a period with termination only on April 15, 1977. The Executive Directors considered the request of the Italian authorities for the approval of the continuation and adaptation of the deposit requirement on November 3 and approved the phasing out of the scheme as noted above. In addition, on October 4 a new 10 per cent tax was imposed on most exchange payments. This tax was to be in effect only for
15 days (until October 18) and was described as intended to delay foreign exchange purchases until new measures to improve the overall fiscal situation had been implemented. No action has been taken on this measure by the Executive Directors.

Following the introduction of the deposit requirement in May, the trade-weighted exchange rate (based on February 1973 parities) strengthened by some 5 percentage points to an effective depreciation of 33.6 per cent at the end of May, and except for a short period late in September, has remained there. The heavy outflow of foreign exchange that occurred in early 1976 was temporarily reversed. Italy's gross foreign exchange reserves increased markedly in June-August 1976, to SDR 5,513 million at the end of August 1976. But in September there was a substantial fall.

The underlying payment situation has remained extremely difficult throughout. The trade balance registered a marked deterioration in the first six months of 1976, but imports increased by 45 per cent in reflection of a sharp recovery of domestic activity and exports increased by 31 per cent over the corresponding period in 1975.

In the light of the critical balance of payments situation of Italy the imposition of the deposit requirement on purchases of foreign exchange was warranted on a temporary basis, and its later extensions have been necessitated by the delay in introducing comprehensive alternative measures that would help restore equilibrium in the balance of payments on a sound and lasting basis.